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# Towards a Modernisation of EU-Russia Legal Relations?

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# TOWARDS A MODERNISATION OF EU-RUSSIA LEGAL RELATIONS?

## ABSTRACT

The legal framework of EU-Russia relations is still determined on the basis of a Partnership and Cooperation Agreement (PCA) that was concluded in 1994 and entered into force on 1 December 1997. Due to internal developments in both the EU and Russia, several provisions of the agreement have become outdated. Russia developed into a market economy and is on the verge of acceding to the World Trade Organisation (WTO). The EU enlarged to 27 – soon 28 – Member States and went through a process of institutional reform. It is argued that in this context, a modernisation of EU-Russia legal relations is urgently needed. The options for a new comprehensive framework agreement are discussed in light of Russia's WTO accession and initiatives for regional economic integration in the post-Soviet space.

## INTRODUCTION

The Partnership for Modernisation, launched at the 2010 Rostov-on-Don EU-Russia summit, is the latest attempt to reinvigorate the so-called 'Strategic Partnership' between Russia and the European Union.<sup>1</sup> It aims to put some flesh on the bones of the rather ambiguous long-term objective to establish four 'Common Spaces', namely a Common Economic Space, a Common Space of Freedom Security and Justice, a Common Space of External Security and a Common Space of Research and Education, including Cultural aspects.<sup>2</sup> Both the Partnership for Modernisation and the Common Spaces agenda have been adopted in the framework of an EU-Russia summit and, therefore, essentially have a political rather than a legal significance. As a result, the implementation of the ambitious cooperation agenda requires the adoption of binding bilateral agreements and takes place – for the time being – within the legal and institutional framework of the Partnership and Cooperation Agreement (PCA).

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1 'Joint Statement on the Partnership for Modernisation, EU-Russia Summit, 31 May – 1 June 2010' (2010), <http://goo.gl/YBwk3>.

2 The ambition to create four Common Spaces was introduced at the May 2003 Saint-Petersburg EU-Russia Summit. The May 2005 Moscow EU-Russia Summit adopted a single package of road maps with action points for the implementation of the new agenda. For comments, see: Van Elsuwege, P. (2008a), 'The Four Common Spaces: New Impetus to the EU-Russia Strategic Partnership?', in Dashwood, A. and Maresceau, M. (eds.), *Law and Practice of EU External Relations. Salient Features of a Changing Landscape*, Cambridge: Cambridge University Press, pp. 334–359.

The PCA has been concluded in 1994 and entered into force on 1 December 1997 for an initial period of ten years.<sup>3</sup> Pursuant to Article 106, the agreement is automatically extended each year unless either side informs the other party of its denunciation at least six months before the expiry date. Whereas, from a legal point of view, the PCA can therefore continue to apply without formal problems, a revision of this framework agreement is urgently needed.

Due to internal developments in both the EU and Russia, several provisions have become outdated. The preamble and Article 1, for instance, refer to Russia as “a country with an economy in transition”, which is no longer appropriate after the recognition of Russia’s market economy status and its (pending) accession to the WTO.<sup>4</sup> Moreover, the level of bilateral co-operation has gradually extended beyond the scope of the PCA. An important weakness in this respect is the relative lack of PCA provisions concerning co-operation in the areas of foreign and security policy or police and judicial cooperation in criminal matters. Finally, the EU’s eastern enlargement and the further extension of EU competences after the adoption of the Amsterdam, Nice and Lisbon Treaties as well as Russia’s more assertive foreign policy in the Putin-Medvedev era, have created a new political context for EU-Russia co-operation.

The asymmetrical nature of the PCA, based upon a unilateral adaptation of Russian legislation to EU values and norms, is difficult to reconcile with Russia’s insistence on ‘equal partnership’. For this reason, the Russian side insisted already in 1999 on “*the joint elaboration and conclusion of a new framework agreement on Strategic Partnership and Co-operation in the 21<sup>st</sup> century*”.<sup>5</sup> Confronted with the limits of a unilateral policy towards Russia in the context of the EU enlargement process, all EU institutions also recognised the need to revise the legal and strategic framework of EU-Russia relations.<sup>6</sup> This resulted in the adoption of the four Common Spaces agenda – replacing the old unilateral Common Strategy on Russia – and a commitment to establish an updated legal framework replacing the PCA.

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3 ‘Agreement on Partnership and Cooperation establishing a partnership between the European Communities and their Member States, of one part, and the Russian Federation, of the other part’ (PCA) (1997), *Official Journal of the European Union*, L 327/3, <http://goo.gl/31ltE>.

4 The WTO ministerial conference approved the accession package on 16 December 2011, allowing Russia to finally join the WTO by July 2012. See: WTO (2012), ‘Accessions. Russian Federation’, <http://goo.gl/SXhPQ>.

5 ‘Medium-Term Strategy for Development of Relations between the Russian Federation and the European Union (2000–2010)’, <http://goo.gl/VLR4w>.

6 Following the difficulties to find an agreement with Russia on the issue of Kaliningrad transit and the extension of the PCA to new EU Member States, the December 2003 European Council instructed a general revision of “all aspects of the Union’s relations with Russia”. As part of this exercise, all EU institutions expressed their dissatisfaction with the at that time existing framework based upon the PCA and a unilateral Common Strategy on Russia. On this point, see: Van Elsuwege, P (2008a), *op. cit.*, pp. 337–339.

The EU and Russia agreed to develop a new, comprehensive framework agreement at their May 2006 Sochi meeting. After a series of problems with new EU Member States and the military conflict between Russia and Georgia, negotiations officially started at the end of 2008.<sup>7</sup> However, this does not mean that the conclusion of a new framework agreement is now a mere formality. Significant legal obstacles still need to be tackled. Issues such as the legal basis of the agreement, the institutional framework, and, foremost, the scope and binding nature of the provisions are all of fundamental importance to attain the objective of a strengthened EU-Russia Strategic Partnership.

In order to address the challenges surrounding the modernisation of EU-Russia legal relations, this paper starts with a critical analysis of the existing legal framework established on the basis of the PCA. In the following section, the options for modernising EU-Russia legal relations are discussed taking into account the progress in the ongoing negotiations for the conclusion of a new bilateral framework agreement. Specific attention is devoted to the implications of Russia's accession to the WTO and the recent initiatives for regional trade integration in the post-Soviet space.

## **THE PARTNERSHIP AND COOPERATION AGREEMENT: A LEGAL FRAMEWORK OF THE PAST**

### ***An Instrument of Transition***

The PCA has to be situated in the specific geopolitical and psychological context after the dissolution of the Soviet Union. Whereas the EU quickly offered the prospect of 'association' and, after the 1993 Copenhagen European Council, also 'accession' to the countries of Central and Eastern Europe (CEECs), the European Commission suggested another type of agreement to Russia and the Newly Independent States

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7 Poland vetoed the planned opening of the negotiations at the November 2006 Helsinki EU-Russia summit in response to Russia's ban on the import of Polish meat. At the following summit meeting, held in Samara on 18 May 2007, EU-Russia relations reached an absolute freezing point. A long list of tensions and mutual disagreements ranging from the future status of Kosovo, the issue of energy supply to the fate of Russian-speaking minorities in Estonia and Latvia implied that, in contrast to previous practice, the summit ended without a Joint Declaration. It was only on the occasion of the 26–27 June 2008 EU-Russia Summit in Khanty-Mansiysk that a new atmosphere in the bilateral relationship could be perceived. This gathering, for the first time chaired by the new Russian President, Dmitry Medvedev, and organized under the auspices of Slovenia as the first new EU Member State to hold the Presidency of the EU, formally launched the negotiations for a new Strategic Partnership agreement. Unfortunately, the new enthusiasm quickly received a major blow with the outbreak of the conflict in Georgia in August 2008 and Russia's unilateral decision to recognize the independence of Abkhazia and South Ossetia. In response, the EU decided at an extraordinary European Council meeting to postpone the negotiations on the new partnership agreement. However, it soon became clear that a long-term postponement of the negotiations was not in the EU's interest. Accordingly, it was decided to start the negotiations in December 2008.

of the former Soviet Union. Accordingly, the concept of 'Partnership' has been introduced as a label that characterizes the EU's external relations with a number of states which are not considered to be potential EU members but are seen as strategically important for the latter.<sup>8</sup> With Russia, a joint political declaration on Partnership and Co-operation was issued during Yeltsin's visit to Brussels in December 1993<sup>9</sup> as a prelude to the Partnership and Co-operation Agreement (PCA) signed in Corfu on June 24, 1994.<sup>10</sup>

The preamble of the PCA reveals that the agreement aims to support Russia's political and economic transition. Together with the strengthening of democratic values, respect for the rule of law and human rights, the key objective is to assist "Russia's progressive integration in the open international trading system". In this respect, the PCA anticipated on the application of WTO rules and underlines the parties' commitment to liberalise trade on the basis of the principles contained in the General Agreement on Tariffs and Trade (GATT).<sup>11</sup> This implies, for instance, the application of the most-favoured-nation (MFN) principle<sup>12</sup> and GATT provisions on freedom of transit<sup>13</sup> and customs valuation, fees and formalities connected with importation and exportation, marks of origin and the publication and administration of trade regulations.<sup>14</sup> Moreover, the Co-operation Council, established under the PCA, is held to take into account "to the greatest extent possible" the interpretations that are given to the relevant articles of the GATT for the interpretation and application of the relevant PCA provisions.<sup>15</sup>

Whereas the introduction of GATT rules in EU-Russia trade relations may have been somewhat revolutionary in the beginning of the 1990s, Russia's economic development and forthcoming accession to the WTO make those provisions virtually redundant in the present day reality of EU-Russia cooperation. The situation is slightly different with regard to the PCA provisions on trade in services. Even though Russia's commitments under the General Agreement on Trade in Services (GATS) largely replicate or exceed the obligations under the PCA, there remain certain commitments, notably with regard to international maritime transport services and the temporary movement of natural persons for business purposes,

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8 Hillion, C. (1998), 'Partnership and Co-operation Agreements between the European Union and the New Independent States of the ex-Soviet Union', *European Foreign Affairs Review*, vol. 3, no. 3, pp. 400-401.

9 European Commission (1993), 'Bulletin EC 1993, 12, 1.3.29'.

10 See note 3.

11 PCA, Preamble.

12 PCA, Article 10.

13 PCA, Article 12.

14 PCA, Article 13.

15 PCA, Article 94.

where the PCA goes further than the GATS.<sup>16</sup> A bilateral agreement in the form of an exchange of letters between the EU and the Russian Federation preserves the continued application of those more beneficial market access conditions after Russia's accession to the WTO.<sup>17</sup>

Despite the PCA's clear objective to prepare the integration of Russia in the world economy, various provisions limit the scope of the liberalisation process.<sup>18</sup> Trade concessions in 'sensitive' sectors such as textiles, coal and steel are left outside the scope of the PCA.<sup>19</sup> Safeguard clauses allow both parties to take 'appropriate measures' when domestic products may be threatened by an increased quantity of imported products.<sup>20</sup> Moreover, the agreement includes general and broadly defined provisions on economic co-operation,<sup>21</sup> but stops short of any regional trade integration. Article 3 PCA only foresees that the parties consider "whether circumstances allow the beginning of negotiations on the establishment of a free trade area". Like many other provisions of the PCA, this so-called "evolutionary clause" is essentially a declaration of intent without any direct legal consequences.

The general nature of the PCA is particularly well-illustrated with the objective to achieve the approximation of Russia's existing and future legislation to that of the EU. While recognising that this process of legislative approximation is an important condition for strengthening the economic links between the parties, Article 55 (1) of the PCA proclaims that Russia "*shall endeavour to ensure* that its legislation be gradually made compatible with that of the Community [now Union]".<sup>22</sup> This can hardly be regarded as a formal legal commitment. Its vague and open-ended formulation gives the Russian authorities a large freedom to define

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16 European Commission (2011a), 'Proposal for a Council Decision on the signing, on behalf of the European Union, and provisional application of, the Agreement in the form of an Exchange of Letters between the European Union and the Russian Federation regarding the preservation of commitments on trade in services contained in the current EU-Russia Partnership and Co-operation Agreement', COM(2011) 721 final, <http://goo.gl/zZT99>, p. 2.

17 'Agreement in the form of an Exchange of Letters between the European Union and the Government of the Russian Federation relating to the preservation of commitments on trade in services contained in the current EU-Russia Partnership and Cooperation Agreement' (2012), *Official Journal of the European Union*, L 57/44, <http://goo.gl/y9yA0>.

18 For a detailed analysis of the trade-related aspects of the PCAs, see: Hillion, C. (1998), *op. cit.*

19 Separate agreements had to be concluded for trade in textile and steel (e.g. Articles 21 and 22 of the PCA). Trade in agricultural products is only covered marginally in the title on "economic cooperation" (Article 60 of the PCA). Significantly, Russia's WTO accession will lead to a further liberalisation in those sectors (*cf. infra*).

20 See PCA, Article 17.

21 The title "Economic Cooperation" in the PCA contains provisions on industrial cooperation, investment promotion and protection, public procurement, co-operation in the field of standards and conformity assessment, education and training, energy, environment, cooperation in science and technology, tourism, monetary policy, social cooperation, money laundering, regional development, information and communication, statistical cooperation, etc.

22 Emphasis added.

the time-schedule and methods of implementation. There is only an obligation to act without a requirement to achieve particular results or a sanction in case the approximation of laws obligation is not fulfilled. Moreover, the approximation clause includes a long list of 'priority areas' for legislative action<sup>23</sup> but fails to provide clear guidelines on the scope and content of the EU laws to be taken as the basis for approximation nor does it include a link with the objective to establish a Free Trade Area in the future.

Also with regard to energy, perhaps the most significant area of EU-Russia cooperation, the PCA remains rather vague. Article 65 only provides that "[c]ooperation shall take place within the principles of the market economy and the European Energy Charter, against a background of the progressive integration of the energy markets in Europe." As is well-known, Russia signed the Energy Charter Treaty (ECT) in 2004 but never ratified the agreement and even decided to withdraw its signature in 2009.<sup>24</sup> As a result, EU-Russia energy cooperation is essentially based on non-legally binding dialogues and commitments. Most important is the EU-Russia energy dialogue, which was established at the EU-Russia Paris summit in 2000 and aims to create trust and transparency in EU-Russia energy relations through the organisation of regular meetings at different political levels. This dialogue *inter alia* resulted in the establishment of an early warning mechanism for preventing and overcoming emergency situations in the energy sector<sup>25</sup> and a common understanding on the preparation of a road map for EU-Russia energy cooperation until 2050.<sup>26</sup> Both instruments are at best described as 'soft law' mechanisms, which certainly have their merits but cannot conceal the lack of legally binding norms regarding investment protection, transit or dispute resolution.

Taking into account the rather limited legal consequences of many PCA provisions, it has been concluded that *"besides its very nice title there is little*

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23 Article 55 (2) of the PCA refers to company law, banking law, company accounts and taxes, protection of workers at the workplace, financial services, rules on competition, public procurement, protection of health and life of humans, animals and plants, the environment, consumer protection, indirect taxation, technical rules and standards, nuclear laws and transport.

24 It is noteworthy that the Permanent Court of Arbitration in The Hague decided in a case between the former shareholders of the Yukos Oil Company against Russia that despite the non-ratification of the ECT by Russia, the ECT's investment protection and arbitration provisions remain binding on Russia for 20 years. This follows from Article 41(1) of the ECT, which explicitly foresees in such a long-term protection in case of provisional application of the agreement. See: 'PCA Case No. AA 226' (2009), <http://goo.gl/BQu5n>.

25 This early warning mechanism was established in 2009 in the wake of the Russia-Ukraine gas crisis and has been updated in 2011. See: 'Memorandum on a Mechanism for Preventing and Overcoming Emergency Situations in the Energy Sector within the Framework of the EU-Russia Energy Dialogue' (2011), <http://goo.gl/Z8M3M>.

26 'Common Understanding on the Preparation of the Roadmap of the EU-Russia Energy Cooperation until 2050' (2011), <http://goo.gl/Y3brR>.



*substance in this Agreement*”.<sup>27</sup> A notable exception is certainly Article 23 of the PCA, which provides that the parties shall ensure within their territory the non-discrimination on grounds of nationality of legally employed workers as far as their conditions of employment, remuneration or dismissal are concerned. In its famous *Simutenkov* judgment, the European Court of Justice confirmed the direct effect of this principle, which means that it can be relied on by individuals before the courts of a Member State.<sup>28</sup> Of course, the application of the non-discrimination principle does not extend to rules on social security or access to employment. The EU Member States remain exclusively competent to determine the conditions for entry to their national labour market. It is only when a Russian national is legally employed in accordance with the national provisions of the host Member State that Article 23 of the PCA can play a role.

### ***Limits of the EU-Russia Institutional Framework***

Perhaps the most important feature of the PCA is the establishment of a regular political dialogue within a multilevel institutional framework including bi-annual EU-Russia summits, ministerial meetings, diplomatic contacts and Parliamentary co-operation. This political dialogue allowed the extension of EU-Russia co-operation beyond the substantive scope of the PCA provisions themselves.<sup>29</sup> Moreover, the PCA institutional structures have been instrumental for finding compromise solutions to EU enlargement related questions such as the transit of persons to Kaliningrad or the extension of the PCA to the EU's new Member States.<sup>30</sup> Of particular importance for solving bilateral problems in the EU-Russia Strategic Partnership is Article 102 of the PCA, which allows the partners “*to discuss any matter concerning the interpretation or implementation of this agreement and other relevant aspects of the relations between the parties*” within the PCA institutions.

The main weakness of the PCA's institutional framework is, however, the absence of a possibility to adopt legally binding decisions. Accordingly, progress in EU-Russia relations is essentially based upon the conclusion of specific bilateral agreements or joint statements with a purely political value. Often, those political statements are nothing more than vague diplomatic declarations without

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27 Maresceau, M. (2001) ‘The EU Pre-Accession Strategies: A Political and Legal Analysis’, in Maresceau, M. and Lannon, E. (eds.), *The EU's Enlargement and Mediterranean Strategies. A Comparative Analysis*, Houndmills: Palgrave, p. 21.

28 Court of Justice of the European Union (2005), ‘Case C-265/03’, <http://goo.gl/Ur0qg>.

29 Maresceau, M. (2004), ‘Bilateral Agreements concluded by the European Community’, *Collected Courses of the Hague Academy of International Law*, p. 430.

30 See: Van Elsuwege, P. (2008b), *From Soviet Republics to EU Member States. A Legal and Political Assessment of the Baltic States' Accession to the EU*, Leiden-Boston: Martinus Nijhoff, pp. 399–402.

any tangible content. Moreover, there is some dissatisfaction with the limited effectiveness of the large number of meetings and dialogues.<sup>31</sup> Particularly after the entry into force of the Lisbon Treaty, which transferred the task of preparing the bi-annual EU-Russia summits from the six-months rotating EU Presidency to European Council President Herman Van Rompuy, the added value of such frequent meetings is put into question.<sup>32</sup>

The limits of the PCA as an instrument for the smooth development of EU-Russia relations were clearly illustrated with the Polish meat crisis of 2005–2007. In the opinion of Poland, Russia's ban on the import of Polish meat was not proportional to the irregularities found and, therefore, infringed Article 19 of the PCA, which forbids the use of veterinary and phytosanitary restrictions on trade between the parties in an arbitrary and unjustified manner.<sup>33</sup> Pursuant to Article 101 of the PCA, disputes relating to the application or interpretation of the agreement may be referred to the Cooperation Council. The latter can, however, only adopt recommendations to settle the problems. In case no solution can be found, conciliators may be appointed, but their recommendations are not binding upon the parties. It is striking that the formal rules of procedure for the settlement of disputes under the PCA have not been used or even contemplated in the Polish meat row. Only after a change of government in Poland and a visit of the new Polish Foreign Minister Radoslaw Sikorski to Moscow, the meat ban and other restrictions on Polish products were lifted in December 2007 and January 2008 respectively.<sup>34</sup>

In the aftermath of the Polish-Russian food crisis, the EU and Russia concluded several Memoranda of Understanding on Sanitary and Phytosanitary (SPS) measures and food safety requirements.<sup>35</sup> However, this could not prevent the emergence of new trade disputes. In the summer of 2011, Russia banned the import of all fresh vegetables from the EU after the discovery of cucumbers with the E.Coli bacteria in Germany. The EU Council quickly qualified this reaction as "scientifically unjustified and disproportionate."<sup>36</sup> In the context of the June 2011 Nizhny Novgorod EU-Russia summit, Russia agreed to replace the ban with a temporary certification system leading to the cancellation of all import restrictions from 9

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31 Council of the European Union (2011a), 'Key outstanding issues for the EU in its relations with Russia', 10073/11.

32 Rettman, A. (2011a) 'No "deliverables" at upcoming EU-Russia summit', <http://goo.gl/X6jPD>.

33 Council of the European Union (2005), 'Problems in exports of meat, meat products and plant products to the Russian Federation', 14533/05.

34 Roth, M. (2009), 'Bilateral Trade Disputes between EU Member States and Russia', *CEPS Working Document*, no. 319, p. 11.

35 For a list of relevant documents, see: <http://goo.gl/LqQWZ>.

36 Council of the European Union (2011b), 'Extraordinary Council Meeting Agriculture, Luxembourg', <http://goo.gl/kDKMg>.

August 2011 onwards.<sup>37</sup> Despite the relatively swift solution of this trade dispute, it appears that a problem with meat or vegetables in a single Member State (or a limited number of Member States) almost automatically interrupts the entire EU-Russia trade flows. The most recent example is Russia's decision to ban the import of EU cattle, pigs and sheep following the outbreak of the so-called Schmallenberg virus in Germany, the Netherlands, Belgium, France, Italy, Luxemburg and the United Kingdom. This decision significantly affects the agricultural sector of the Baltic States, which send up to 75 per cent of their live pigs exports to Russia.<sup>38</sup> Of course, this raises speculations about the possible political inspiration of Russia's decision so shortly after the negative Latvian referendum on the use of Russian as a state language.

In a joint reaction, European trade Commissioner Karel De Gucht and his colleague responsible for health and consumer policy, John Dalli, strongly condemned Russia's reaction as disproportionate and unjustified, particularly in light of Russia's commitments under its WTO accession package. Under the WTO Agreement on the Application of Sanitary and Phytosanitary Measures, import restrictions aimed to protect human, animal or plant life or health have to be based on scientific evidence, may not arbitrarily or unjustifiably discriminate between Members where identical or similar conditions prevail and cannot be applied in a manner which would constitute a disguised restriction on international trade.<sup>39</sup> In the absence of scientific evidence that the Schmallenberg virus poses any threat to humans and taking into account that pigs, which fall within the ban, are not affected by the virus, it seems that the Russian decision fails to respect the WTO standards. It remains to be seen whether Russia's WTO accession – and the availability of the WTO dispute settlement mechanisms (*cf. infra*), will be able to solve this issue. In any event, the long list of key outstanding issues in EU-Russia relations<sup>40</sup> as well as the recurrence of often politically motivated trade irritants reveal the limits of the PCA in establishing an EU-Russia Strategic Partnership based on the rule of law.

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37 'Commission welcomes Russia's decision to cancel temporary import requirements for fresh EU vegetables' (2011), MEMO/11/552, 08.08.2011, <http://goo.gl/wTF7l>.

38 Keating, D. (2012), 'Russia bans live animal imports from the EU', *European Voice*, 20.03.2012, <http://goo.gl/PRu3w>.

39 'The WTO Agreement on the Application of Sanitary and Phytosanitary Measures', Article 3, <http://goo.gl/BdUzX>.

40 Council of the European Union (2011a), *op. cit.*

## THE LONG AND WINDING ROAD TO A NEW FRAMEWORK AGREEMENT

On the occasion of the June 2008 EU-Russia Summit in Khanty-Mansiysk, the leaders of the EU and the Russian Federation issued a Joint Statement “on the launch of negotiations for a new EU-Russia Agreement”. According to this official document:

“[T]he aim is to conclude a *strategic agreement* that will provide a *comprehensive framework* for EU/Russia relations for the foreseeable future and help to develop the potential of our relationship. It should provide for a *strengthened legal basis* and *legally binding commitments covering all main areas of the relationship, as included in the four EU/Russia common spaces* and their road maps which were agreed at the Moscow Summit in May 2005”.<sup>41</sup>

Significantly, the EU and Russia aim to establish the necessary legal instruments for the implementation of the Common Spaces road maps, which form the main political framework of the Strategic Partnership.<sup>42</sup> A key advantage of the Common Spaces concept is certainly the fact that, for the first time, the EU and Russia agreed upon a joint and comprehensive agenda for future cooperation including a wide variety of issues ranging from, among others, the deepening of trade relations and energy cooperation to internal and external security, the fight against organised crime, weapons of mass destruction, migration and asylum, culture and education.<sup>43</sup> The ambition to include all those issues in a bilateral framework agreement raises interesting legal questions as regards the division of competences in the EU’s internal legal order and the procedural rules to be followed.

### **Legal and Procedural Requirements**

A first outstanding issue is the internal legal basis of the new agreement. One of the options could be to adopt a ‘Strategic Association Agreement’, based on Article 217 of the TFEU.<sup>44</sup> However, the political connotation of ‘association’, suggesting

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41 ‘Joint Statement on the launch of negotiations for a new EU-Russia agreement’ (2008), <http://goo.gl/S2T2i>. [emphasis added]

42 On the concept of Common Spaces in EU-Russia relations, see: Van Elsuwege, P. (2008a), op. cit..

43 For a summary of the scope of issues covered by the four Common Spaces agenda, see: European Commission (2007), *The European Union and Russia. Close Neighbours, Global Players, Strategic Partners*, <http://goo.gl/qhBjb>.

44 Article 217 of the TFEU states that “The Union may conclude, with one or more States or international organisations, agreements establishing an association involving reciprocal rights and obligations, common action and special procedure”. On the suggestion to use this as a legal basis for EU-Russia relations, see: Vahl, M. (2004), ‘Whither the Common European Economic Space? Political and Institutional Aspects of Closer Economic Integration between the EU and Russia’, in De Wilde d’Estmael, T. and Spetschinsky, L. (eds.), *La politique étrangère de la Russie et l’Europe. Enjeux d’une proximité*, Brussels: Peter Lang, p. 178.

an asymmetrical relationship between the partners, which is based upon a strong conditionality approach and the unilateral approximation to EU rules and policies, is difficult for Russia to accept politically. For this reason, the 1999 Medium-term Strategy explicitly ruled out Russia's accession to or 'association' with the EU.<sup>45</sup>

Article 8 of the TEU, introduced with the Treaty of Lisbon, could provide a way out of the legal basis discussion.<sup>46</sup> According to this provision:

"1. The Union shall develop a *special relationship with neighbouring countries*, aiming to establish an area of prosperity and good neighbourliness, founded on the values of the Union and characterised by close and peaceful relations based on cooperation.

2. For the purposes of paragraph 1, *the Union may conclude specific agreements with the countries concerned*. These agreements may contain *reciprocal rights and obligations as well as the possibility of undertaking activities jointly*. Their implementation shall be the subject of periodic consultation."<sup>47</sup>

At first sight, Article 8 of the TEU might be an interesting instrument to upgrade the PCA without entering into a formal association status. However, the conditionality approach and in particular the idea that the relationship is "founded on the values of the EU" may not meet Russia's expectations. Notwithstanding the consensus on an abstract set of common values,<sup>48</sup> the interpretation of those concepts may be different. On several occasions, Putin and Medvedev argued that the principles of democracy and liberty must be interpreted in line with Russia's national values, in particular the aspiration to strengthen the statehood and sovereignty of Russia.<sup>49</sup> In a recent opinion, Vladimir Putin once again expressed his general dissatisfaction with how the issue of human rights is handled globally and accused the 'Western states' of 'dominating' and 'politicising' the human rights agenda to the detriment of Russia's interests.<sup>50</sup>

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45 See note 5.

46 Van Elsuwege, P. and Petrov, R. (2012), 'Article 8 TEU: Towards a New Generation of Agreements with the Neighbouring Countries of the European Union?', *European Law Review*, vol. 36, no. 5, pp. 688–703.

47 *Official Journal of the European Union* (2008), 'Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union', C 115/1. [emphasis added]

48 For instance, the Road Map for the Common Space on External Security explicitly states that "The EU and Russia share common values, as defined in the Helsinki Final Act as well as in the PCA and other relevant international documents notably respect for international law, including respect for democratic principles and human rights, including the rights of persons belonging to minorities, equality and respect of mutual interests".

49 Petrov, R. and Leino, P. (2009), 'Between "Common Values" and Competing Universals: The Promotion of the EU's Common Values through the European Neighbourhood Policy', *European Law Journal*, vol. 15, no. 5, pp. 667–670.

50 Putin, V. (2011a), 'Russia and the Changing World', <http://goo.gl/euxrf>. (The original article in Russian was published in *Moskovskiy Novosti*.)

Obviously, the different reading of the events in South Ossetia or Abkhazia and the diverging perceptions about the legal position of Russian-speaking minorities in Estonia and Latvia significantly affect the prospects for a fruitful EU-Russia cooperation under the terms of Article 8 of the TEU. However, also when the new agreement would be based on Article 212 of the TFEU regarding economic, financial and technical cooperation with third countries in combination with a range of more specific legal bases on the other issues included in the agreement (e.g. environment, culture, education etc.) or when a more limited agreement on trade and investment would be concluded under Article 207 of the TFEU, the EU's position has to be consistent with the principles and objectives of its external action as laid down in Article 21 of the TEU.<sup>51</sup> Hence, the 'value' dimension is a fundamental aspect of the EU's post-Lisbon external action, which cannot be ignored in the discussions surrounding the modernisation of EU-Russia legal relations.

Apart from the sensitivities surrounding the political orientation of the new agreement, which is to be reflected in the choice of legal basis, significant procedural hurdles have to be overcome. Arguably, an agreement covering the entire spectrum of EU-Russia cooperation requires unanimity in the Council and the consent of the European Parliament.<sup>52</sup> Moreover, the inclusion of policy areas going beyond the EU's exclusive competences implies that also the Member States will have to be involved in the conclusion and ratification procedure of a new framework agreement. An important drawback of the mixed procedure is the internal ratification of the agreement in all Member States, which becomes a very cumbersome and lengthy process in a Union of 27 countries.

In order to counterbalance the long delays for the implementation of mixed agreements, it is common practice to conclude a separate interim agreement on trade and trade related matters or to apply provisionally certain provisions of the agreement through a separate exchange of letters between the EU and the third party.<sup>53</sup> Such a scenario where at least the provisions on trade and investment enter into force rather quickly may be an interesting option in the short term. Given the EU's extended exclusive competence on common commercial policy (CCP) under Article 207 of the TFEU, an interim agreement may be concluded between the EU

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51 According to Article 21 (1) of the TEU, "The Union's action on the international scene shall be guided by the principles which have inspired its own creation, development and enlargement, and which it seeks to advance in the wider world: *democracy, the rule of law, the universality and indivisibility of human rights and fundamental freedoms, respect for human dignity, the principles of equality and solidarity, and respect for the principles of the United Nations Charter and international law.*" [emphasis added]

52 See Article 218 of the TFEU for the rules on the conclusion of international agreements on behalf of the EU.

53 See: Maresceau, M. (2004), op. cit., pp. 209–210.

and Russia without the requirement of conclusion and ratification on the part of the individual Member States.

### ***Key outstanding issues: energy and visa***

Russia's WTO accession significantly facilitates the progress of negotiations on the trade aspect of EU-Russia relations. However, differences of opinion regarding the inclusion of so-called 'WTO plus' provisions, allowing for a level of liberalisation and legal approximation exceeding the requirements under the WTO agreement, and the EU's intention to include a substantial energy chapter based on the principles of the Energy Charter Treaty (ECT) complicate the negotiations. Given Russia's dissatisfaction with the latter agreement, leading to its withdrawal in 2009 (cf. *supra*), it remains to be seen whether it will be prepared to accept a reintroduction of those principles through the back door of a new EU-Russia agreement. Moreover, it is no secret that Russia is not very happy with the EU's Third Energy Package, which requires the effective separation between the operation of electricity and gas transmission networks from supply and production activities of vertically integrated energy companies.<sup>54</sup> Significantly, undertakings from third countries, which intend to acquire control over an electricity or gas network, need to comply with the same unbundling requirements as EU undertakings. If they do not comply with these requirements, they should be refused the certification, which is required for distribution system operators.<sup>55</sup> This, of course, has significant implications for *Gazprom*, which faces a legal obligation to 'unbundle' the ownership and operation of its gas pipelines on EU territory and to allow access to these pipelines to other energy companies. Vladimir Putin described this requirement as 'robbery' and 'confiscation of Russian property' and announced that Russia would take the necessary steps to challenge the validity of the EU energy legislation.<sup>56</sup>

In Russia's view, the Third Energy Package is contrary to Article 34 (1) PCA, which spells out that the parties shall use their best endeavours to prevent a deterioration of the market conditions under which their respective companies operate.<sup>57</sup> In addition, Moscow announced to raise the issue in the WTO after its accession to this

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54 See: European Commission (2012), 'Third package for Electricity & Gas markets', <http://goo.gl/OSDX5>.

55 This follows from Article 11 (also known as the '*Gazprom clause*') of Directive 2009/73 of 13 July 2009 concerning common rules for the internal market in natural gas, *Official Journal of the European Union* (2009a), L 211/94; a similar clause is included in Directive 2009/72 regarding the internal market in electricity, *Official Journal of the European Union* (2009b), L 211/54.

56 Rettman, A. (2011 b), 'Putin and Barroso in public scrap on EU energy law', *EU Observer*, 24.02.2011, <http://goo.gl/Jw51T>.

57 Transcript of Press Conference between Vladimir Putin and José Manuel Barroso in February 2011, <http://goo.gl/nuVye>.

organisation.<sup>58</sup> The 'Gazprom clause' raises questions of compatibility with different provisions of the General Agreement on Trade in Services (GATS) such as the Most Favourite Nation Principle (Art. II GATS), the prohibition of market access barriers (Art. XVI GATS) and the national treatment obligation (Article XVII of GATS).<sup>59</sup> Finally, Russia may invoke investment protection clauses included in bilateral investment treaties (BITs) concluded with certain EU Member States. Particularly for the new Member States, those agreements have been concluded before their accession to the Union and, therefore, potentially escape the application of EU law in accordance with Article 351 (1) of the TFEU, which states that international agreements concluded by EU Member States before their accession to the Union shall not be affected by the provisions of the EU Treaties.<sup>60</sup> Taking into account the high stakes, both in terms of financial and strategic interests, the importance of this energy battle can hardly be underestimated. As Katinka Barysch observed, the energy dispute "is likely to keep EU judges and competition officials busy for years to come".<sup>61</sup>

Another issue that is expected to remain at the centre of EU-Russia discussions is certainly the prospect of a visa free regime. On the occasion of the December 2011 EU-Russia summit, both partners agreed on concrete steps to facilitate the mobility of citizens.<sup>62</sup> The introduction of biometric passports and increased efforts to combat illegal immigration and improve border management prepare the ground for visa-free short travel in the future. However, so far the EU has been reluctant to communicate a clear target date for the lifting of the visa requirement. Several EU Member States fear the risks of excessive immigration and organised crime. The conclusion of Europol's Organised Crime Threat Assessment (OCTA) that visa liberalisation with Russia "may lead to widespread abuse" would "undoubtedly present new opportunities for organised crime groups in illegal immigration"

58 *PeakOil.com* (2011), 'Russia may contest EU energy rules in WTO', <http://goo.gl/UiMrR>.

59 For an analysis, see: Van Hoorn, V. (2009), 'Unbundling, Reciprocity and the European Internal Energy Markets: WTO Consistency and Broader Implications for Europe', *European Energy and Environmental Law Review*, vol. 18, no. 1, pp. 51–76; Cottier, T., Matteotti-Bertukova, S. and Nartova, O. (2010), 'Third Country Relations in EU Unbundling of Natural Gas Markets: The 'Gazprom clause' of Directive 2009/97 EC and WTO law', *NCCR Trade Regulation*, <http://goo.gl/Ut1Yu>.

60 A interesting precedent of such a situation is the preferential market access granted to the Swiss energy company ATEL, which is regarded as an investment protected under the 1990 bilateral agreement between the Swiss Confederation and the Czech and Slovak Federative Republic. Even though this preferential treatment is not compliant with EU Directive 2003/54 concerning common rules for the internal market in electricity, the European Court of Justice considered that EU law could not apply by virtue of Article 351 (1) TFEU. See: Court of Justice of the European Union, Case C-264/09, *Commission v. Slovakia*, Judgment of 15 September 2011, not yet reported. For comments, see: Boute, A. (2012), case note on Case C-264/09, *Common Market Law Review*, forthcoming.

61 Barysch, K. (2011), 'The EU and Russia: All smiles and no action?', *Centre for European Reform Policy Brief*, <http://goo.gl/JKbMx>.

62 European Council (2011), 'EU-Russia Summit to improve citizen's mobility', <http://goo.gl/8llio>.



support this position.<sup>63</sup> Nevertheless, the prospect of visa freedom remains a key priority for Russia and further progress in this field, for instance on the basis of a more concrete action plan or the negotiation of a specific visa waiver agreement, may be required to reconcile both parties' positions.

## **RUSSIA'S ACCESSION TO THE WTO: A MODERNISATION OF EU-RUSSIA TRADE RELATIONS**

In anticipation of a new framework agreement, Russia's WTO accession already entails a significant modernisation of EU-Russia legal relations, at least as far as the trade dimension is concerned. Without entering into a detailed analysis, six important implications can be identified.

*First*, Russia's WTO accession package entails clear-cut commitments on *further trade liberalisation* leading to a more transparent and predictable environment for trade and foreign investment. On average, the legally binding ceiling for import duties on goods will be reduced to 7.8 per cent, compared to a pre-accession average of 10 per cent; for agricultural products there will be an average reduction from 13.2 per cent to 10.8 per cent.<sup>64</sup> Significantly, Russia's 'temporary' anti-crisis measures adopted since 2008 and including tariff increases on a wide range of products will be abolished. Those measures had a very negative impact on EU exports, particularly after their extension to the Russia-Kazakhstan-Belarus customs union in 2010. Despite the Union's argument that this unannounced increase violated Article 16 of the PCA, which explicitly requires prior consultations within the Cooperation Committee before changes to import tariff policies are introduced, it is only in the context of Russia's WTO accession that a solution to the tariff increases could be found.

Apart from the lowering of import tariffs, the WTO accession package also fixes export duties for over 700 tariff lines, including sectors such as fisheries, mineral fuels and wood.<sup>65</sup> The latter is of particular importance for the EU, certainly for its Nordic Member States which are major importers of Russian wood products. Since 2007, Russia has introduced several new export duties on raw timber, officially to accelerate the restructuring of the Russian wood and paper industry and to address environmental concerns, but for the EU, this practice constitutes an indirect subsidy to domestic downstream users.<sup>66</sup> Russia's WTO accession will end

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63 Europol (2011), *OCTA 2011. EU Organized Crime Threat Assessment*, <http://goo.gl/KPTkf>.

64 WTO (2011), 'Working Party seals the deal on Russia's membership negotiations', 10.11.2011, <http://goo.gl/ihov6>.

65 See: Part V of Russia's Schedule of Concessions and Commitments.

66 Forsberg, T. and. Seppo, A. (2009), 'Power without Influence? The EU and Trade Disputes with Russia',

this practice and increase the legal certainty for trade in wood products. In addition to the WTO commitments on reduced export tariffs, the EU and Russia concluded an agreement, in the form of an exchange of letters, relating to the administration of tariff-rate quotas applying to exports of wood from Russia to the EU.<sup>67</sup> Hence, a transparent system of quota allocations to EU importers, administered by the European Commission in cooperation with the Russian customs authorities, aims to avoid the speculative trading of tariff quota entitlements.

In order to reduce the risk of new export duties being introduced or increased in the future, the EU and Russia concluded a supplementary agreement concerning trade in raw materials which are not covered under Russia's WTO Schedule of Concessions and Commitments on Goods.<sup>68</sup> This agreement, also concluded in the form of an exchange of letters, provides that the Russian Federation "shall make its best efforts not to introduce or increase export duties" for a list of raw materials that are included in an annex to the letters. This more than 20 pages long list, including materials ranging from green tea and tobacco to liquefied natural gas and petroleum oils, includes products "for which Russia has more than 10% of global production or exports, or where the EU has major import interest either existing or potential, or where there is a risk of tension in global supplies".<sup>69</sup> Apart from the intention not to introduce or increase the export duties on those products, Russia also commits to hold consultations with the European Commission at least two months before such measures would nevertheless be contemplated. Even though this supplementary bilateral agreement between the EU and Russia does not entail hard legal commitments, it nevertheless reveals an engagement to improve the stability and predictability of the bilateral trade relations.

*Second*, apart from new legal commitments on improved market access for goods and services, the perspective of Russia's WTO accession also triggered *a solution to long-standing trade irritants*. For instance, following the WTO principle of national treatment, the Russian system of tariffs for rail freight transport can no longer discriminate between domestic and international destinations. A similar reasoning applies regarding the use of discriminatory road charges on good vehicles.<sup>70</sup> Of particular significance is certainly the solution to the issue of Siberian overflight rights. As a heritage from the Soviet period, EU air carriers flying over Siberia to destinations in Asia have to pay an overflight fee which costs around €

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*Europe-Asia Studies*, vol. 61, no. 10, p. 1816.

67 *Official Journal of the European Union* (2012a), L 57/3, <http://goo.gl/njvCv>.

68 *Official Journal of the European Union* (2012b), L 57/53, <http://goo.gl/8fKn4>.

69 *Ibid.*

70 Council of the European Union (2011a), *op. cit.*

330 million a year, mostly to the benefit of *Aeroflot*.<sup>71</sup> For a long time, the EU has argued that this practice is violating international law, more specifically Article 15 of the Chicago Convention on International Civil Aviation,<sup>72</sup> as well as EU competition rules. An agreement to gradually eliminate the charge of Siberian overflight rights was initialled between the Commission and the Russian government in November 2006 as part of the EU's bilateral negotiations on Russia's WTO accession. However, the Russian side refused to proceed with the conclusion of the agreement until the entire WTO accession negotiation process was finished. This explains why the 2006 agreement only entered into force in 2012, leading to the gradual reduction of payments and their abolishment from 2014 onwards.

An additional problem regarding air transport concerns Russia's long-term refusal to accept so-called 'EU designation clauses' in its bilateral Air Service Agreements (ASAs) with individual EU Member States. Such clauses provide that benefits granted to national carriers of the Member State concerned are equally granted to all EU carriers.<sup>73</sup> The absence of such an EU designation clause has created serious practical problems, for instance, following the takeover of Austrian Airlines by Lufthansa. Russia started to argue that flights operated by Austrian Airlines would no longer fall under the Russian-Austrian ASA, which created legal uncertainty as to whether Austrian Airlines could continue its operations over Russian territory.<sup>74</sup> Similar problems occurred after the merger of Iberia and British Airways or the takeover of Belgian Brussels Airlines by Lufthansa. In order to solve this issue, the European Commission launched infringement procedures against several Member States and raised the issue on the occasion of the October 2011 EU-Russia aviation summit. Russia has recently for the first time accepted the introduction of an EU designation clause in its bilateral ASA with Finland, which could become a template for its bilateral ASAs with all other EU Member States.<sup>75</sup>

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71 Forsberg, T. and Seppo, A (2009), op. cit., p. 1810.

72 According to this provision "no charge shall be imposed by any Contracting Party solely for the right of transit over or entry into or exit from its territory of any aircraft of the Contracting Party or persons or property thereon". See: 'Convention on International Civil Aviation' (1944), <http://goo.gl/tpphB>.

73 The obligation for EU Member States to include an 'EU designation clause' in their bilateral aviation agreements follows from the *Open Skies* judgments where the Court found that national clauses in aviation agreements restricting international traffic rights to nationals carries infringed the EU Treaty provisions on freedom of establishment. See e.g. Court of Justice of the European Union (2002), 'Case C-466/98; I-9427', <http://goo.gl/ciDB2>.

74 European Commission (2011b), 'Air transport: Infringements concerning bilateral aviation agreements with Russia', MEMO/11/167, 14.03.2011, <http://goo.gl/IX84U>.

75 'EU-Russia Common Spaces Progress Report 2010', <http://goo.gl/zNDmq>.

In the longer run, the conclusion of a horizontal EU-Russia air transport agreement could be a logical next step in the modernisation process.<sup>76</sup>

*Third*, Russia's WTO accession also provides *a minimum legal framework for EU-Russia energy relations*. Despite the absence of specific WTO agreements on energy, general WTO rules such as the Most Favoured Nation (MFN) and National Treatment (NT) principles also apply to trade in energy goods and services.<sup>77</sup> One of the most controversial issues is the WTO compatibility of Russia's dual pricing policy for energy. While domestic gas prices are set by the government at a level that is considered reasonable for domestic consumers, export prices are established on the basis of supply and demand in the importing country. This discrepancy in energy prices may be regarded as an unfair competitive advantage for Russian industrial producers and exporters benefitting from state subsidies. Hence, the question arises whether this practice is in line with WTO law, in particular with the Agreement on Subsidies and Countervailing Measures (SCM).

Only subsidies that are specific to an enterprise or industry, a group of enterprises of industries or a region are actionable under WTO rules. Significantly, Article 2 of the SCM Agreement prohibits not only *de jure* but also *de facto* specific subsidies. In order to establish whether this is the case, several factors are taken into account such as the number of enterprises that receive a subsidy, predominant use by certain enterprises, disproportionately large subsidies to certain enterprises and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy. Taking into account that Russian domestic energy prices apply to all enterprises and industries throughout the country, it appears very difficult to prove that those conditions of selectivity are fulfilled.<sup>78</sup>

In contrast to Saudi Arabia, which agreed to abandon its dual pricing system as part of its WTO accession package, Russia did not want to give in on this point. There is only a commitment to gradually increase the domestic gas prices and to determine those prices "on the basis of normal commercial considerations, based on recovery of costs and profit".<sup>79</sup> In addition, price controls on domestic

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76 It is noteworthy that already in 2005, the European Commission proposed such a "comprehensive air transport agreement", see: European Commission (2005), 'A Framework for Developing Relations with the Russian Federation in the field of Air Transport', COM(2005) 77 final, 14.03.2005, <http://goo.gl/Kpoyi>.

77 Marceau, G. (2010), 'The WTO in the Emerging Energy Governance Debate', *Global Trade and Customs Journal*, vol. 5, no. 3, pp. 83–93.

78 Ripinsky, S. (2004), 'The System of Gas Dual Pricing in Russia: Compatibility with WTO Rules', *World Trade Review*, vol. 3, no. 3, p. 463; Silovanova, Y. (2007), 'The WTO and Energy. WTO Rules and Agreements of Relevance to the Energy Sector', *International Centre for Trade and Sustainable Development*, p. 30.

79 'Report of the Working Party on the Accession of the Russian Federation to the World Trade Organization' (2011), WT/ACC/RUS/70, 17.11.2011, para. 132, <http://goo.gl/8mfem>.

gas are to be transparent and not to be used for purposes of protecting domestic products. Under those circumstances, the system of dual energy pricing is as such not precluded after Russia's WTO accession. Nevertheless, it cannot be excluded that the WTO Dispute Settlement Body will be asked to verify the compatibility of Russia's energy policy with its commitments under WTO law.

*Fourth*, the new legal context will also have significant *implications for the EU's trade policy*. For instance, it will no longer be possible to apply import quotas for Russian steel.<sup>80</sup> Moreover, it may become more difficult to use trade defence instruments. Although Russia has been granted market economy status already in 2002, the EU has so far applied 'energy adjustment costs' in the application of its anti-dumping policies *vis-à-vis* Russia.<sup>81</sup> In practical terms, this means that in order to determine whether a given Russian company's products are dumped on the EU market, i.e. sold under a price that is considered to be their normal value, not the domestic Russian energy costs, but a reference price from other markets is used as the point of reference. The direct consequence is that the dumping margin attributed to Russian products and the anti-dumping duties imposed on this basis are higher than if the actual Russian production price would be taken into account. Following Russia's WTO accession it may be difficult to argue that Russian domestic prices are kept artificially low, since they will be considered to be based on commercial grounds (cf. *supra*).

*Fifth*, Russia's WTO accession is expected to *improve the level of protection of intellectual property rights* (IPR). Under Article 54 and Annex 10 of the PCA, Russia agreed to establish a protection regime for IPR which is "similar to that existing in the EU". However, such standards have not been implemented yet, as evidenced by the annual US Trade Representative report on intellectual property protection in third states.<sup>82</sup> The application of the WTO agreement on Trade Related aspects of Intellectual Property Rights (TRIPS) provides an additional legal basis and a further incentive to modernise Russia's IPR legislation. Similar improvements are expected

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80 European Commission (2011c), 'Proposal for a Regulation of the European Parliament and the Council repealing Council Regulation (EC) No 1342/2007 on administering certain restrictions on imports of certain steel imports from the Russian Federation', COM(2011) 715 final, <http://goo.gl/7ONHN>.

81 Article 2 of the EU's basic anti-dumping Regulation 1225/2009 (*Official Journal of the European Union* (2009c), L343/51.) provides that the normal value of a product can be calculated on the basis of the cost of production or on the basis of representative export prices and information from other markets – instead of the domestic price of the exporting country – when prices are considered artificially low. This rule significantly reduced the impact of Russia's recognition of a market economy. See: Engelbutzeder, O. (2004), *EU Anti-Dumping Measures against Russian Exporters In View of Russian Accession to the WTO and the EU Enlargement 2004*, Berlin: Peter Lang, pp. 166–167.

82 Due to serious problems regarding the enforcement of intellectual property legislation, Russia is on the 'priority watch list' of countries with a weak system of legal protection. See: Office of the United States Trade Representative (2011), '2011 Special 301 Report', <http://goo.gl/FbvCP>.

with regard to *foreign investment protection*. In recent years, foreign investors regularly faced problems particularly in the strategic oil and gas sectors. A well-known example is the forced transfer of assets from Dutch Shell to Gazprom for the exploitation of the Shakalin II project in 2006.<sup>83</sup> It is expected that the application of the WTO Agreement on Trade-Related Investment Measures (TRIMS) will avoid such scenarios in the future.

*Sixth*, Russia's WTO accession implies that future trade disputes with the EU will fall under the *dispute settlement* mechanism of the WTO. This rather sophisticated mechanism involves different stages starting with consultations between the parties and potentially leading to adjudication by expert panels and the Appellate Body. Alternatively, disputes can be solved on the basis of arbitration, conciliation or mediation.<sup>84</sup> Notwithstanding the limits of this system, such as the sometimes time-consuming and cumbersome procedures or the lack of direct effect in the domestic legal order of most WTO members, the authority of WTO dispute settlement rulings cannot be underestimated. In this respect, it is noteworthy that China, a country which has traditionally been reluctant to submit its disputes with other countries to international adjudication, has become an active participant in WTO dispute settlement proceedings.<sup>85</sup> It remains to be seen whether Russia will follow a similar path, but the availability of the WTO dispute settlement mechanism is in any event a significant improvement in comparison to the rather weak procedures under the PCA (cf. *supra*).

## **THE WAY FORWARD: FREE TRADE FROM LISBON TO VLADIVOSTOK?**

Russia's WTO accession could, in principle, open the gates to the negotiation of a *free trade* agreement with the EU as provided under Article 3 of the PCA (cf. *supra*). However, such an option is highly uncertain following Russia's economic integration initiatives in the post-Soviet space. In particular, the existence of a customs union between Russia, Kazakhstan and Belarus in the context of the Eurasian Economic Community (EurAsEC) and Vladimir Putin's recent proposals on the development of a Eurasian Union constitute significant legal and political obstacles for the realisation of this scenario.

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83 See: *Euractiv.com* (2006), 'EU voices anger over Russia's move to halt Sakhalin project', 20.09.2006, <http://goo.gl/PiRyn>.

84 For a detailed overview of the WTO Dispute Settlement Mechanism, see: Van Den Bossche, P. (2008), *The Law and Policy of the World Trade Organization*, Cambridge: CUP, pp. 269–307.

85 Manjiao, C. (2012), "China's Participation in WTO Dispute Settlement over the Past Decade: Experiences and Impacts", *Journal of International Economic Law*, vol. 15, no. 1, pp. 29–49.

Even though the EU formally supports the process of regional cooperation between the countries of the former Soviet Union,<sup>86</sup> a level of trade integration leading to a common customs territory precludes the prospects for bilateral trade liberalisation in the relations between the EU and Russia. The only alternative option is to enter into a free trade arrangement with the customs union as a whole but this is not very attractive for the EU taking into account the economic and political situation in Belarus and Kazakhstan. Entering into free trade negotiations with the authoritarian regimes of Nazarbayev and Lukashenko would be contradictory to the conditionality approach underlying the EU's external action. Moreover, both countries are not members of the WTO, which has always been a precondition for the Union to even contemplate the start of free trade negotiations.

It is remarkable that those considerations do not play a role for the European Free Trade Association (EFTA). Although a bilateral FTA was first envisaged between only Russia and the EFTA States, the negotiations have been expanded to include Belarus and Kazakhstan after the formation of the EurAsEC customs union.<sup>87</sup> Russian attempts to follow a similar path in its negotiations with the EU have so far been unsuccessful and it is unlikely that the EU's position on this issue will change. On the other hand, Russia does not seem prepared to abandon its close links with Belarus and Kazakhstan. To the contrary, on several occasions Vladimir Putin has indicated that further regional trade integration is a political priority for Russia.

Apart from Russia's renewed interest in the establishment of a free trade area within the Commonwealth of Independent States (CIS),<sup>88</sup> Putin launched the idea to develop the Belarusian-Kazakh-Russian customs union into a full-fledged Eurasian Union, including all republics of the former Soviet Union and leading to a single currency, common institutions and a passport-free zone in the future. In Putin's view, the future Eurasian Union will then enter into negotiations with the EU to set up "a harmonised community of economies stretching from Lisbon to Vladivostok, a free trade zone and even more sophisticated integration patterns".<sup>89</sup>

This project may sound attractive, but cannot conceal a number of practical problems. First, there is a lack of trust among the post-Soviet states, which has

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86 This is explicitly recognised in the preamble to the PCA.

87 The negotiations between the four EFTA States and the three members of the Customs Union have been launched on 23 November 2010. See: <http://goo.gl/u3Z7d>.

88 In autumn 2011, Russia took the initiative to sign a new CIS FTA after it had refused to ratify a similar agreement from 1994. The new agreement was signed on October 18, 2011 by eight CIS members, including Russia, Ukraine, Belarus, Kazakhstan, Armenia, Kyrgyzstan, Moldova and Tajikistan. Russia was the first to conclude the ratification process on 1 April 2012, followed by Belarus a few weeks later. The agreement will enter into force following the ratification of three signatories.

89 Putin, V. (2011b), 'A new integration project for Eurasia: The future in the making', 04.10.2011, <http://goo.gl/vkh4z>.

prevented the successful implementation of previous attempts of regional integration.<sup>90</sup> Second, Putin's proposal may essentially be regarded as an attempt to counterbalance the EU's Eastern Partnership initiative. This policy framework, which was launched shortly after the 2008 Russia-Georgia war as part of the European Neighbourhood Policy (ENP), aims at the political association and economic integration of the eastern neighbours.<sup>91</sup> In this context, the EU and Ukraine recently initialled a new Association Agreement, including the prospective establishment of a Deep and Comprehensive Free Trade Area (DCFTA). The formal conclusion of this agreement would preclude Ukraine's participation in any kind of regional integration project with Russia going beyond free trade. If, on the other hand, Ukraine would decide to enter the EurAsEC customs union, it will have to abandon its free trade arrangement with the EU.<sup>92</sup>

In other words, both the EU and Russia have a fundamentally different vision on the development of their shared neighbourhood. For the Union, the creation of a DCFTA with Ukraine is a crucial first step towards a Neighbourhood Economic Community, i.e. a free trade area encompassing the EU Member States and its neighbours based upon a common regulatory framework defined by EU standards and norms. For Russia, the priority is the expansion of the EurAsEC customs union as a building block of a future Eurasian Union. The success of this project also stands or falls with the participation of Ukraine. Hence, despite the rhetoric of 'free trade from Lisbon to Vladivostok' and the ambition to create a 'common economic space' between the EU and Russia, incompatibilities between the ENP inspired process of economic integration and Russian initiatives to reintegrate the post-Soviet space loom around the corner. Legal and political frictions regarding the position of Ukraine or the EurAsEC customs union risk to undermine the modernisation of EU-Russia relations and complicate the progress of negotiations on a new framework agreement.

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90 See e.g. Shadikhodjaev, S. (2009), 'Trade Integration in the CIS Region: A Thorny Path Towards a Customs Union', *Journal of International Economic Law*, vol. 12, no. 3, pp. 555–578.

91 Lannon, E. and Van Elsuwege, P. (2012), 'The Eastern Partnership. Prospects of a New Regional Dimension within the European Neighbourhood Policy', in Lannon, E. (ed.), *The European Neighbourhood Policy's Challenges*, Brussels: Peter Lang, pp. 285–322.

92 Van der Loo, G. and Van Elsuwege, P. (2012), 'Competing Paths of Regional Economic Integration in the Post-Soviet Space: Legal and Political Dilemmas for Ukraine', *Review of Central and East European Law*, forthcoming.



## CONCLUSIONS

Both within the EU and in Russia there is a consensus that the legal framework of their bilateral relationship needs modernisation. The PCA reflects the spirit of the early 1990s, but does not seem adapted to the new challenges of the 21<sup>st</sup> century. The weak dispute settlement mechanism, the impossibility to adopt legally binding decisions and the absence of formal legal provisions on issues such as energy and migration are the most obvious examples. Even though this has been partially solved through the conclusion of specific bilateral agreements and Russia's accession to the WTO, an updated bilateral framework agreement remains important for reasons of legal certainty and to ensure that the Strategic Partnership is based on a solid institutional structure.<sup>93</sup> However, several issues complicate the negotiations that started back in 2008.

First, both partners have different perceptions on the interpretation of fundamental values such as respect for the rule of law, democracy and human rights. The European Parliament's strong condemnation of the irregularities in the preparation and conduct of the recent parliamentary and presidential elections<sup>94</sup> as well as European Council President Van Rompuy's open letter to outgoing Russian President Dmitry Medvedev regarding the lack of progress in the investigation of the murder on Sergey Magnitsky<sup>95</sup> illustrate the Union's concerns. Given the importance attached to the export of EU values in the Treaty of Lisbon, it is impossible to escape this issue in the context of EU-Russia relations. This is particularly the case because the European Parliament, which is traditionally more sensitive to human rights issues, has become a more active actor in the EU's external action. Moreover, Russia's complicated bilateral relationship with certain EU Member States implies that the conclusion and ratification of a new agreement promises to be a difficult and long-term exercise.

Second, energy is not surprisingly a hot issue in EU-Russia relations. More than 30 per cent of all EU energy imports come from Russia whereas the Union is by far Russia's most important trading partner in energy goods. Between 70 and 80 per cent of all Russian gas and oil exports are destined for the EU market.<sup>96</sup> Despite the obvious mutual interdependence, both partners have different strategic interests leading to opposing views on the preferred legal framework. For Russia, 'security

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93 Van Elsuwege, P. (2009), 'Towards a New Strategic Partnership Agreement: EU-Russia Relations at the Crossroads', <http://goo.gl/ec7Jt>.

94 European Parliament (2012), Resolution on the outcome of the presidential elections in Russia, P7\_TA(2012)0088, <http://goo.gl/XGDGr>.

95 See: Rettman, A. (2012), "EU President: Magnitsky case 'emblematic' for Russia", *EU Observer*, 20.04.2012, <http://goo.gl/4Xr1m>.

96 European Commission (2012b), 'EU-Russia Energy Relations', <http://goo.gl/99BYh>.

of demand' is crucial. Therefore, a market structure with vertically integrated gas companies operating on the basis of long-term contracts and delivering gas through their own pipelines with no freedom of access to other suppliers is in Russia's interest. This '*Gazprom* strategy' is at the core of Russia's energy policy. For the EU, however, 'security of supply' is a key concern and for this reason a diversification of suppliers is essential. This explains the requirement of 'unbundling' in the EU's Third Energy Package and the increased attention to alternative sources such as liquefied natural gas (LNG) and other 'unconventional' gas. Obviously, the legal requirements following from the Third Energy Package are difficult to reconcile with the *Gazprom* strategy. Pipeline politics and Russia's dual energy pricing mechanism further complicate the energy discussions.

Third, Vladimir Putin may be right when he assessed that "a genuine partnership between Russia and the European Union is impossible as long as there are barriers that impede human and economic contacts, first and foremost visa requirements".<sup>97</sup> However, there is a widespread fear within the Union that an abolishment of the visa requirement would increase migratory pressures and organised crime. Despite the adoption of Common Steps towards visa free short travel for Russian and EU citizens, there seems not much appetite within the Union to discuss a full-fledged visa waiver agreement.

Fourth, there is a risk of clashing neighbourhood strategies. Putin's proposals on the establishment of a Eurasian union and the sometimes subtle pressure on countries such as Ukraine and – to a lesser extent – Moldova to join the EurAsEC customs union irritate the European Union policy makers. Such scenarios undermine the ENP, which is based on a strong conditionality approach, legal approximation and the establishment of bilateral DCFTAs. A further intensification of regional economic integration in the post-Soviet space based upon the already existing EurAsEC customs union significantly limits the EU's abilities to influence the domestic legal framework of the countries concerned.

The connecting factor between all identified problem areas (values, energy, visa, neighbourhood relations) is a lack of trust between the parties. In this context, the negotiation of a new framework agreement is a very difficult exercise. Moreover, the ratification process may take several additional years. In the meantime, the modernisation of EU-Russia legal relations takes place in a piecemeal fashion and remains a work in progress.

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97 Putin, V. (2011a), op. cit.

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